SHEARMAN & STERLING LLP

FOCUS ON TAX CONTROVERSY AND LITIGATION

In First Case Involving Privilege Related to UTPs, District Court in *Wells Fargo* Protects Opinion Work Product in Tax Accrual Workpapers

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This month's newsletter also features articles discussing Revenue Procedure 2013-32, which restricts PLRs for spin-offs and other corporate nonrecognition transactions, a Florida district court's holding that the Administrative Procedure Act did not bar its review of IRS adjustments made to partnership returns that included penalties despite an IRS Announcement providing waiver of penalties, and the SEC's novel, but successful effort to seek disgorgement in the form of unpaid federal income taxes in *SEC v. Wyly*.

District Court Protects Opinion Work Product Contained in Tax Accrual Workpapers in *Wells Fargo*

The US District Court for the District of Minnesota granted in part and denied in part Wells Fargo's petition to quash three summonses relating to tax accrual workpapers ("TAWs") issued to Wells Fargo and its independent auditor, KPMG, after Wells Fargo refused to provide its TAWs for tax years 2007 and 2008.[1] The government sought to obtain information regarding Wells Fargo's financial reporting and uncertain tax positions ("UTPs").

Background

Wells Fargo participated in sale-in-lease-out ("SILO") transactions between 1997 and 2003. Since 2004, Wells Fargo had not taken any tax deductions for transactions designated as listed transactions at the time of the filing of its returns. Nevertheless, Wells Fargo filed claims for refunds related to its SILO transactions in 2005 and 2006

[1] *Wells Fargo & Co. v. United States*, No. 10-57 (D. Minn. June 4, 2013).

and had, at the time the summonses in question were issued, informed the Internal Revenue Service ("IRS") that it potentially would file refund claims with respect to the transactions for 2007 and 2008. In 2011, the Federal Circuit affirmed a decision of the Court of Federal Claims ruling against Wells Fargo with respect to its SILO claims. After the appellate court's decision, Wells Fargo informed the IRS that it would not file refund claims for listed transactions in the 2007 and 2008 tax years. The government did not withdraw its summonses for Wells Fargo's tax accrual workpapers.

Legal Standard

The IRS has "broad latitude" when adopting enforcement mechanisms to perform tax collection and assessment.[2] Under *United States v. Powell*,[3] to enforce a summons, the government must show that (1) its investigation has a legitimate purpose; (2) the inquiry may be relevant to that purpose; (3) the information sought is not already in the possession of the government; and (4) the administrative steps required by the Internal Revenue Code have been followed. The government may make a *prima facie* case for enforcement by showing good faith compliance with summons requirements, and once the government has met this burden, the taxpayer may rebut the government's *prima facie* case by showing that the *Powell* requirements were not met or that enforcing the summons would be an abuse of the court's enforcement powers.

Improper Purpose

Editor's Note: "Improper purpose" is an extremely difficult argument to sustain.

As an initial matter, Wells Fargo argued that the government had an improper purpose in issuing the summonses. The court found that the IRS has established a legitimate purpose in requesting Wells Fargo's TAWs, namely, verifying that Wells Fargo's tax return was substantially correct. This was especially true in the case of Wells Fargo because it had engaged in abusive tax avoidance techniques in the past.

The court also rejected Wells Fargo's claims that the IRS could identify Wells Fargo's UTPs on the Schedule M-3 or the Reportable Transaction Disclosure Statements, or use other methods to verify Wells Fargo's statements on its returns. The documents identified by Wells Fargo as providing the same information were not as comprehensive and the government only needed to show that the TAWs were relevant to the audit under the *Powell* standard.

[2] *United States v. Arthur Young & Co.*, 465 US 805, 820 (1984) citing *United States v. Euge*, 444 US 707, 716 n. 9 (1980).

[3] 379 US 48, 57-58 (1964).

The court did not find that the IRS wanted to punish or deter Wells Fargo for its past behavior but found instead that the government had a proper purpose for its summonses and did not violate its own policy of restraint in issuing the summonses. "Even if deterring tax avoidant behavior was one motivating factor in issuing the summons," the court held that "[a]s long as there is a legitimate purpose in issuing a summons, the existence of another purpose does not render the summons illegitimate."[4]

Work-Product Doctrine

Wells Fargo contended that much of the information sought was protected by the work-product doctrine. The court reiterated the near absolute protection for opinion work product and closely followed *Simon v. G.D. Searle & Co.*,[5] in which the Eighth Circuit discussed the "because of" test that it applies to work-product cases. In that case, a company was required to disclose aggregate data from business documents but could redact individual case reserve figures that revealed attorney mental impressions, thoughts, and conclusions. The Eighth Circuit in *Simon* explained:

> "'Although the [. . .] documents were not themselves prepared in anticipation of litigation, they may be protected from discovery to the extent that they disclose the individual case reserves calculated by [Defendant]'s attorneys. The individual case reserve figures reveal the mental impressions, thoughts, and conclusions of an attorney in evaluating a legal claim. By their very nature they are prepared in anticipation of litigation and, consequently, they are protected from discovery as opinion work product.'"[6]

Editor's Note: Corporations may want to consider involving attorneys in evaluating UTPs.

The court analyzed whether the information contained in Wells Fargo's TAWs was prepared in anticipation of litigation and whether it was protected opinion work product. Because attorneys were not initially involved in identifying UTPs, the district court held that identifying the UTPs was done in the ordinary course of business, not in anticipation of litigation. The court also found that it was unlikely that Wells Fargo would litigate every UTP because Wells Fargo stated that it would not enter into a transaction related to a UTP unless it had a seventy percent or greater certainty that a court would uphold the tax benefits from the transaction and the IRS and Wells Fargo would not litigate every UTP.

4 *Wells Fargo* at 64.

5 816 F.2d 397 (8th Cir. 1987).

6 *Wells Fargo* at 70, citing *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8 th Cir. 1987).

The court held that Wells Fargo's recognition and measurement analysis reflected in the TAWs constituted protected work product. Although the TAWs were created in the ordinary course of business to comply with financial reporting requirements, the recognition and measurement analysis was sufficiently tied to possible litigation and not merely created for FIN 48 analysis. Because this analysis was sufficiently tied to possible litigation, the court held that these documents were prepared in anticipation of litigation. The court rejected the government's claims that Wells Fargo had waived work-product protection by disclosing the TAWs to KPMG. The government had argued that KPMG was Wells Fargo's adversary or a conduit to Wells Fargo's adversary and, under Eighth Circuit precedent, disclosure to an adversary constituted a waiver. The court held that Wells Fargo must disclose the identity of its UTPs, the process for identifying its UTPs, and underlying facts regarding the UTPs, but not its recognition or measurement analysis.

"Although the *Wells Fargo* court cited to the *Textron* decision in support of certain conclusions and did not go so far as to extend the protection to cover tax accrual workpapers in their entirety, it acknowledged that the tax accrual workpapers contained opinion work product and protected that information."

The Wells Fargo decision is a departure from the *Textron* case. In *Textron*, the First Circuit held that work-product protection did not extend to preparing tax accrual work papers because they were required by audit even though in house tax lawyers were involved in their preparation and the tax reserve amounts would not have been prepared but for the fact that Textron anticipated the possibility of litigation. Although the *Wells Fargo* court cited to the *Textron* decision in support of certain conclusions and did not go so far as to extend the protection to cover tax accrual workpapers in their entirety, it acknowledged that the tax accrual workpapers contained opinion work product and protected that information.

Attorney-Client Privilege

Wells Fargo claimed attorney-client privilege with respect to eight emails that had not been disclosed to anyone outside Wells Fargo in which a Wells Fargo attorney was either a sender or recipient. The documents fell into three categories: (1) emails identifying the UTPs with drafts of UTP cover sheets, including recognition and measurement analysis; (2) allegedly privileged emails discussing the applicability of work-product protection and the attorney client privilege to Wells Fargo's TAWs; and

(3) emails discussing issues related to the settlement of UTPs. The court held that all three categories constituted documents that fell within the attorney-client privilege.[7]

Conclusion

"Involving attorneys in the Schedule UTP and TAW process may strengthen work-product claims."

The district court's decision ordering the redaction of opinion work product within the TAWs reflects that certain documents may contain both discoverable information prepared in the ordinary course of business and attorney mental impressions, thoughts, and analysis. Involving attorneys in the Schedule UTP and TAW process may strengthen work-product claims.

—Lawrence M. Hill & Liz McGee

IRS Restricts Private Letter Rulings for Spin-Offs and Other Corporate Nonrecognition Transactions

The IRS announced on June 25, in Revenue Procedure 2013-32, that while the IRS will continue to issue private letter rulings on certain "significant issues" in connection with proposed corporate transactions, it will not rule on whether a transaction will qualify for nonrecognition treatment under sections 332[8] (liquidations of subsidiaries), 351 (transfers to controlled corporations), 355 (spin-offs, split-offs, etc.), 368 (reorganizations) or 1036 (exchanges of stock for stock of same corporation) ("Nonrecognition Provisions").[9] Generally, a significant issue for these purposes is "an issue of law the resolution of which is not essentially free from doubt and that is germane to determining the tax consequences of the transaction."[10] The IRS also announced that, as under its previous policy, it generally will not rule on an issue that is "clearly and adequately addressed" by statute, regulations, court decisions, revenue

7 The IRS also sought information relating to Wells Fargo's state and local tax returns. Wells Fargo claimed that such information was irrelevant to the IRS audit, but the government claimed that state and local TAWs were potentially relevant for identifying inconsistencies in Wells Fargo's federal tax position. The court found that the government failed to make a *prima facie* case the state and local TAWs were even potentially relevant.

The court also found that the TAWs relating to Wells Fargo's newly acquired subsidiary, Wachovia, were irrelevant to Wells Fargo's federal tax liability for 2007 and 2008 when Wachovia filed its own separate consolidated federal returns. Accordingly, the court did not enforce the IRS summons with regard to the Wachovia documents.

8 All section references are to the Internal Revenue Code and all references to regulations are to the Treasury regulations issued thereunder, unless otherwise noted.

9 Rev. Proc. 2013-32, 2013-28 I.R.B. 1.

10 *Id.*, § 5.02.

rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin ("Comfort Ruling"), whether or not the issue is "essentially free from doubt." The IRS may in its discretion, however, issue a Comfort Ruling (other than a ruling as to whether a transaction will qualify for nonrecognition treatment under Code sections 332, 351, 355, 368 or 1036) if the IRS is otherwise ruling on another issue arising in the same transaction.[11] The IRS described the adoption of the new policy on rulings as an effort to conserve IRS resources.

"Taxpayers have until August 23, 2013 to send spin-off and other ruling requests."

The new policy applies only to ruling requests postmarked or, if not mailed, received after August 23, 2013 (including supplemental ruling requests).[12] Thus, taxpayers have until that date to send spin-off and other letter ruling requests to the IRS Office of Associate Chief Counsel (Corporate) in order to receive a ruling providing that, under one or more Nonrecognition Provisions, no gain or loss will be recognized in a proposed transaction. After the new policy becomes effective, corporate taxpayers that might have sought rulings on a proposed nonrecognition transaction will have to determine whether to proceed on the basis of an opinion of counsel as to all issues other than those determined by the IRS to be significant issues.

For several years, the IRS has had a policy of not ruling on whether a proposed transaction qualifies to be treated under sections 332, 351, 368 (other than section 368(a)(1)(D) and (G)) or 1036 unless the taxpayer's ruling request presents a significant issue.[13] Under this policy, the IRS had defined a "significant issue" as an issue of law that meets the three following tests: (1) the issue is not clearly and adequately addressed by a statute, regulation, decision of a court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin; (2) the resolution of the issue is not essentially free from doubt; and (3) the issue is legally significant and germane to determining the major tax consequences of the transaction.[14] For these purposes, an issue of law is considered not clearly and adequately addressed by the authorities above, and its resolution will not be essentially free from doubt when, because of concern over a legal issue (as opposed to a factual issue), the taxpayer's counsel is unable to render an unqualified opinion on what the tax consequences of the transaction will be.[15] Prior to the effectiveness of Rev. Proc. 2013-32, if the IRS determines that there is a significant issue, the IRS will

[11] *Id.*, § 5.01(2).
[12] *Id.*, § 7.
[13] *See* Rev. Proc. 2001-3, 2001-1 C.B. 111, § 3.01(29).
[14] Rev. Proc. 2013-3, 2013-1 I.R.B. 113, § 3.01(41).
[15] *See id.*

generally rule on the entire integrated transaction and not just the significant issue,[16] except to the extent that issues presented by the integrated transaction are subject to an issue-specific no-rule policy. Such "no-rule issues" include whether a distribution satisfies the business purpose requirement of section 355, whether the distribution is being used principally as a device for the distribution of earnings and profits, and whether the distribution and any direct or indirect acquisition of stock are part of a plan or series of related transactions described in section 355(e)(2)(A)(ii).[17] The IRS also does not rule on the treatment of "North-South" transactions, recapitalizations into control of the controlled corporation in connection with a section 355 distribution, and stock-for-debt swaps intended to qualify for nonrecognition treatment under section 361.[18] Furthermore, a ruling request must include representations which in many cases further limit the issues of law that are addressed by the IRS's rulings.

Rev. Proc. 2013-32 announces that the IRS will not rule on the application of Nonrecognition Provisions, but will rule on significant issues related to their application. The IRS will likewise rule on the application of Code provisions that deal with the tax consequences (such as nonrecognition and basis) of transactions that qualify (or may qualify) under one or more Nonrecognition Provisions only to the extent that a significant issue under those related provisions is presented. For example, a section 351 exchange that does not present any significant issues under section 351 may present a significant issue regarding the application of section 358 to the transferor in the exchange. In such a case, the IRS will rule only on the significant issue under section 358.[19]

Notwithstanding this general approach,[20] under the new policy the IRS reserves its right to rule on any other issue in, or part of, a transaction that is the subject of a ruling request (including ruling adversely) if the IRS believes that it is in the best interests of tax administration.

"[U]nder the new policy the IRS reserves its right to rule on any other issue in, or part of, a transaction that is the subject of a ruling request (including ruling adversely) if the IRS believes that it is in the best interests of tax administration."

16 Since 2009, as an exception to this general policy of ruling on entire transactions, the IRS has had a pilot program under which taxpayers may request letter rulings that address only one or more significant issues arising in connection with a section 355 transaction, or only certain steps in an integrated transaction involving a section 355 distribution, and such requests would be considered and acted upon by the IRS on an expedited basis. Rev. Proc. 2009-25, 2009-24 I.R.B. 1088.

17 Rev. Proc. 2003-48, 2003-2 C.B. 86.

18 *See* Rev. Proc. 2013-3, § 5.01(9), § 5.01(10), and § 5.02(2).

19 Rev. Proc. 2013-32, 2013-28 I.R.B. 1, § 4.01(4).

20 Rev. Proc. 2013-32, § 4.01(2); cf. Rev. Proc 2013-3, § 2.01.

Many of the IRS's practices under its previous letter ruling policy will continue indefinitely. For example, the IRS will continue not to rule on the no-rule issues identified by prior announcements (including "North-South" transactions, recapitalizations into control, stock-for-debt swaps, business purpose and "device" issues under section 355 and whether a series of transactions is a "plan" under section 355(e)).[21] In any ruling request pertaining to a Nonrecognition Provision that is submitted after August 23, 2013, taxpayers are required to provide the information and representations described in relevant revenue procedures,[22] but only to the extent that such information and representations relate to significant issues.

Supplemental letter ruling requests are also covered by the new policy announced in Rev. Proc. 2013-32. Specifically, the IRS announced that a change of circumstances arising after a transaction has been completed ordinarily will not present a significant issue on which the IRS would issue a supplemental letter ruling.[23]

In its announcement of the new policy, the IRS encourages taxpayers to call the Office of Associate Chief Counsel (Corporate) before submitting a letter ruling request on a significant issue (or significant issues), to find out if the IRS will actually entertain the request.

—Derek Kershaw

"A representative partner disclosed information pursuant to IRS Announcement 2002-2, [in which] the IRS agreed to waive accuracy-related penalties for taxpayers who voluntarily disclosed tax shelter involvement."

Kearney Partners Tax Shelter Rulings Address Judicial Review of Penalty Assertions by the IRS and Privilege Questions

May 22nd Order Permitting Review of Penalty Relief Under Announcement 2002-2

The US District Court for the Middle District of Florida considered in a May 22 order whether judicial review of penalty assertions by the IRS was appropriate based on an IRS announcement that provided a waiver of penalties in exchange for disclosure of participation in various alleged tax shelters.[24] The taxpayers were partnerships

[21] Rev. Proc. 2013-32, § 4.01(5).

[22] The revenue procedures that provide instructions on how to request rulings on the application of the Nonrecognition Provisions include Rev. Proc. 81-60, 1981-2 C.B. 680; Rev. Proc. 83-59, 1983-2 C.B. 575; Rev. Proc. 86-42, 1986-2 C.B. 722; Rev. Proc. 90-52, 1990-2 C.B. 626; and Rev. Proc. 96-30, 1996-1 C.B. 696.

[23] Rev. Proc. 2013-32, § 4.02.

[24] *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC, Tax Analysts Document Service Doc. 2013-12655 (M.D. Fla. 2013).

involved in a complex series of alleged tax shelter transactions. A representative partner disclosed information about the transactions to the IRS pursuant to IRS Announcement 2002-2 (the "Announcement"). In the Announcement, the IRS agreed to waive accuracy-related penalties for taxpayers who voluntarily disclosed tax shelter involvement by following the rules and procedures in the Announcement. After the disclosure, the IRS proposed adjustments to the tax returns of the partnerships and their partners along with the imposition of significant accuracy related penalties. In the District Court, the partnerships challenged the penalties based on the waiver in the Announcement. The IRS argued that the court could not review their determinations under the Announcement, including whether the partnerships' disclosure satisfied the rules in the Announcement for a penalty waiver, based on the Administrative Procedures Act ("APA").

"The IRS claimed the resolution of the penalty issue was committed to their discretion by law and therefore unreviewable."

The APA generally provides a presumption of judicial review of final agency actions, other than situations where a statute precludes such review or when the agency's action is "committed to agency discretion by law."[25] The IRS claimed the resolution of the penalty issue was committed to their discretion by law and therefore unreviewable. The court distinguished the type of agency rules that govern internal operations and do not have the force of law from the rules of agencies that "regulate the rights and interests of others," which are binding on the agency and subject to judicial review.[26] For the framework of its analysis, the court quoted *Port of Jacksonville Maritime Ad Hoc Committee, Inc. v. US Coast Guard*, pursuant to which the reviewing court will:

> [d]etermine whether the regulation was intended 1) to require the agency to exercise its independent discretion, or 2) to confer a procedural benefit to a class to which complainant belongs, or 3) to be a 'mere aid' to guide the exercise of agency discretion. If the first or second, [review and] invalidate the action; if the third, a further determination must be made whether the complainant has been substantially prejudiced. If he has, invalidate the action; if not, affirm.[27]

[25] *Id*. (quoting *Lincoln v. Vigil*, 508 US 182, 190-91 (1993)).

[26] *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC, Tax Analysts Document Service Doc. 2013-12655 (M.D. Fla. 2013).

[27] 788 F.2d 705,708 (11th Cir. 1986).

"According to the court, the main purpose of the Announcement was to provide a benefit to taxpayers, rather than internal regulation of IRS affairs."

The court found that the Announcement was "an agency-wide directive designed to confer important benefits to taxpayers" who disclosed their involvement in tax shelters. Further, because tax penalties are often significant to taxpayers, the IRS was not merely establishing internal or "housekeeping" rules when it offered to waive them.[28] According to the court, the main purpose of the Announcement was to provide a benefit to taxpayers, rather than internal regulation of IRS affairs. Without judicial review, the court noted that taxpayers who relied on the waiver would be deprived of a benefit available to other taxpayers. The court also cited cases finding judicial review to be appropriate in situations where an agency fails to observe its own limits imposed on its discretion and invited reliance on those limitations.

The IRS argued that the Announcement did not show intent by the IRS to limit its discretion and did not provide standards that are appropriate for judicial review of its penalty decisions. The court looked at the language of the Announcement and the circumstances to reach the opposite conclusion. First, the use of the phrase "the IRS *will* waive the accuracy-related penalty" for disclosed shelters, as opposed to the use of "may" or "should," suggested that the agency intended to be bound by the Announcement.[29] Secondly, an internal memorandum stated that the IRS was "committed to waiving the accuracy-related penalty" for disclosures under the Announcement.[30] Moreover, the Announcement's list of procedural and substantive requirements for a penalty waiver provided the law or standards necessary for judicial review of penalty decisions. Therefore, the court held that it could review whether the partnerships' disclosure satisfied the requirements for a penalty waiver under the Announcement.

"The court held that it could not review whether the IRS had followed internal procedures regarding penalties that were described in a separate, non-public memorandum."

However, the court also held that it could not review whether the IRS had followed internal procedures regarding penalties that were described in a separate, non-public memorandum. The memorandum directed examiners to obtain approval from the Director of Field Operations ("DFO") before imposing accuracy-related penalties. The partnerships alleged that the Office of Chief Counsel, rather than the DFO, made the decision about penalty relief in their case. In contrast with the Announcement, the court noted that the memorandum was intended to "aid in the internal administration of the IRS" and did not confer rights on the taxpayers. Moreover, the partnerships did not allege that the memorandum was publicized or that they relied on it to their

[28] *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC, Tax Analysts Document Service Doc. 2013-12655 (M.D. Fla. 2013).

[29] *Id*.

[30] *Id*.

detriment. Since the deviation from policy did not deprive the partnerships of any rights afforded to similar taxpayers and merely concerned internal procedures of the agency, the court held that judicial review was not warranted.

December 2012 Order Finding IRS Communications to be Outside the Scope of the Attorney-Client Privilege

An earlier order of the US District Court for the Middle District of Florida addressed a motion by the plaintiff partnerships to compel production of internal IRS communications and documents sent between senior counsel from the IRS's Large Business and International Division and field agents.[31] The partnerships claimed that attorney-client privilege did not apply because the government attorney was acting in a non-legal capacity.

The government opposed the motion to compel production in part because it claimed the documents were protected by the attorney client privilege. The communications took place between an IRS attorney and IRS employees working on the tax shelter and related cases. The plaintiffs argued that the attorney was merely another IRS employee working on the case and was not functioning as an attorney providing legal advice, which is necessary for the privilege to apply. The IRS asserted that the privilege

should apply because the attorney was the counsel of record in Tax Court cases involving certain of the parties and issues arising out of the tax shelter in the current proceeding. The court did not "find good cause to support a claim for the attorney client privilege" because the government did not claim or demonstrate that "the documents reveal protected mental impressions, trial strategy, or legal advice" of the attorney that was related to the current action or that "the previous cases involved information that would be directly related to the same issues" involved in this case.[32] In a later February 4, 2013 order, the court clarified its decision by noting that the documents were addressing a factual issue and not specific legal advice.[33] The documents were "merely communications between IRS employees regarding the Plaintiffs' case and not specified legal advice that would fall under the attorney client privilege."[34] The fact that the communications came from an attorney was not by itself sufficient for the privilege to attach.

"The fact that the communications came from an attorney was not by itself sufficient for the privilege to attach."

31 *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC, Tax Analysts Document Service Doc. 2013-11723 (M.D. Fla. 2012).

32 *Id*.

33 *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC (M.D. Fla. 2013).

34 *Id*.

"Although there were facts in the documents, the facts were so intertwined with the deliberative process that separating the facts was not possible."

Despite the absence of attorney client privilege protection in the December 2012 order, the court found that the deliberative process privilege protected some of the documents and communications. The deliberative process privilege generally protects and encourages candid discussions among the officials and employees of governmental agencies in order to enhance the quality of governmental decision-making. The privilege protects opinions, rather than facts, when the material was prepared to assist an agency decision maker and is a direct part of the deliberative process that makes recommendations or expresses legal or policy opinions. The court found that the requested IRS documents were within the scope of the deliberative privilege and presented "internal opinions, conclusions and recommendations" of IRS employees regarding decisions to be made about the plaintiff's tax situation.[35] Although there were facts in the documents, the facts were so intertwined with the deliberative process that separating the facts was not possible. Therefore, the December order denied the plaintiff's motion to compel production. The later February 4th order clarified that certain documents protected only by the IRS claim of attorney client privilege must be disclosed.

July 2012 Order Finding Taxpayers' Documents to be Privileged

A previous order from another court, the US District Court for the District of New Jersey, denied the government's motion to compel production of pre-litigation documents and communications between the partnerships and its advisors that discussed the alleged tax shelter. The court found that the communications were legal and tax advice concerning the transactions at issue and the possibility of future litigation. Additionally, the Court took notice that the partnerships certified that they would not rely on the advice in the communications during the controversy. Moreover, the government had not shown that it would lose access to vital information for its defense if the privilege was applied. Although some documents were voluntarily disclosed, the partial waiver did not require a full subject matter waiver because the government did not show that there would be disadvantage or inequity if the remainder of the privileged documents were not also disclosed.[36]

Even if the communications were not protected by the attorney client privilege, the court noted that they would be protected by the work product doctrine because the

[35] *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC, Tax Analysts Document Service Doc. 2013-11723 (M.D. Fla. 2012).

[36] *Kearney Partners Fund, LLC v. US*, No. 2:10-cv-153-FtM-99SPC (M.D. Fla. 2013).

"motivating purpose behind" them was "to aid in future litigation."[37] Although litigation might not have been pending at the time the communications were made, they were intended to advise the partnerships about the complexity of the investments that "could lead to legal exposure" and future litigation.[38]

Lastly, the court stated that the crime fraud exception did not defeat the privilege because the government had not shown that there was intent to commit fraud when the investment in the transactions was made.

—Dan Smith

Southern District of New York Permits SEC to Seek Disgorgement of Unpaid Taxes

"The SEC argued that the measure of disgorgement was the amount of federal income tax that the Wylys allegedly avoided."

The US District Court for the Southern District of New York permitted the SEC to seek disgorgement of unpaid taxes in an opinion and order dated June 13, and held that such relief did not impermissibly impinge upon the Secretary of the Treasury's exclusive authority to assess and collect taxes.[39] The Wylys allegedly failed to disclose their beneficial ownership of certain securities in filings with the Securities and Exchange Commission ("SEC"). Because of an earlier ruling, the only monetary relief available to the SEC in their suit against the Wylys was disgorgement. The SEC argued that the measure of disgorgement was the amount of federal income tax that the Wylys allegedly avoided.

According to two of the court's earlier opinions in the case, the Wylys set up certain foreign trusts to create the appearance of non-grantor trusts when they were in fact grantor trusts. The government alleged that by misrepresenting certain trust features, the Wylys created an unjust tax benefit. In 2003, the Wylys attempted to settle issues relating to the trusts with the IRS. In connection with the revelations about the trusts, one IRS official suggested that there might be a possible violation of federal securities laws in connection with the Wyly's disclosures relating to their trusts. Under federal securities laws, any person who acquires beneficial ownership of more than five percent of a class of registered shares must file a statement disclosing such ownership with the SEC.[40]

[37] *Id*.

[38] *Id*.

[39] *SEC v. Wyly*, No. 10-5760 (SDNY June 13, 2013).

[40] *See* 15 USC. § 78(m)(d)(1).

The court held that the SEC was not foreclosed as a matter of law from seeking disgorgement in an amount equal to the amount of taxes that the Wylys had avoided. The court weighed the well-established principle that a district court has broad equitable power in determining appropriate remedies under the securities laws with the Secretary of the Treasury's exclusive authority to assess and collect taxes. The court found that this was not a civil action for the collection of taxes, so it did not fall within the IRS's exclusive authority. The court stated that neither the Tax Code nor the Exchange Act barred the SEC or the court from "using tax benefits as a measure of unjust enrichment in other contexts."

The court held that if the SEC prevails on its fraud claims, the government and the Wylys may argue whether there is a sufficient causal connection between the securities violations and the tax law. Acknowledging the possibility of double enforcement by the IRS and the SEC, the court welcomed input from the Secretary of the Treasury regarding whether it would pursue the Wylys for alleged tax avoidance.

—Liz McGee

Swiss Parliament Rejects US Tax Deal

On June 19, Switzerland's lower house of parliament rejected legislation backed by the upper house that would have permitted Swiss banks to cooperate with the US to turn over confidential client information without breaking Switzerland's strict client secrecy laws. The goal of the legislation was to help settle a protracted dispute with the US over allegations that Swiss banks assisted US citizens to evade taxes and to protect Swiss banks from US criminal prosecution.

If adopted by the Swiss government, it was expected that the US would make a unilateral amnesty offer to Swiss banks to hand over client information without violating Swiss law, and to pay the US a civil fine. The fallout from the rejected agreement is unclear, but, without the bill's passage, Swiss banks may now face criminal charges in the US.

"Secrecy of the details regarding the US agreement appears to have sunk its passage."

Secrecy of the details regarding the US agreement appears to have sunk its passage, and many Swiss legislators in the lower house expressed concern regarding the amount of information Swiss banks would be required to exchange about customers, wealth managers, fiduciaries, and trustees. Others feared that Swiss taxpayers may have to pay a substantial bill if state owned banks received severe penalties from the US. The Swiss People's Party voiced the strongest opposition and considered the bill to be an act of surrender to the US. The Swiss Parliament is now on summer recess so passage is unlikely. Some senior Swiss government officers have suggested that the government may allow some banks to exchange information with the US, but such disclosures may fall short of the proposed US – Swiss Agreement.

Swiss Finance Minister, Eveline Widmer-Schlumpf reportedly told Swiss lawmakers that the US is planning to bring criminal charges against some Swiss banks and that without the legislation there is a "a very real danger of an escalation" in the dispute between the two countries. "Rejecting the bill will lead to a difficult situation, threatening the economy and undermining the reputation of Switzerland's financial center," she warned. We must now await Washington's reaction to the Swiss' rejection.

—*Richard A. Nessler*

US Seeks Identities of Wegelin's Former American Clients

"The request for legal assistance would help the US identify Wegelin's former American clients."

Swiss Federal Tax Authorities notified Wegelin on June 14 to comply with a US request for legal assistance made under the 1996 double taxation agreement between Switzerland and the United States.[41] The request for legal assistance would help the US identify Wegelin's former American clients. According to published reports, the request seeks information regarding Wegelin's clients who were listed as beneficiaries of asset management companies during the past decade and are suspected of fraud.[42] A Wegelin official stated that Wegelin would provide the requested information.

This is the fourth request against a Swiss financial institution. UBS, Credit Suisse, and Julius Baer have received similar requests, and it is expected that the US will seek information from approximately ten other Swiss banks now under investigation.

—*Liz McGee*

41 "US continues hunt for tax dodgers in Swiss banks," International Service of the Swiss Broadcasting Corporation, June 14, 2013, appearing at http://www.swissinfo.ch/eng/politics/US_continues_hunt_for_tax_dodgers_in_Swiss_banks.html?cid=36154372.

42 *Id*. citing a report appearing the same day in the *Neue Züricher Zeitung*.

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Tax Controversy and Litigation at Shearman & Sterling

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